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Tax Panels Submit Reports

A major reform of Japan's tax system took another step forward April 28 when the government and Liberal Democratic Party tax advisory bodies submitted recommendations to Prime Minister Noboru Takeshita. While both call for the introduction of a new indirect tax, the two reports differ on its form. Both recommend significant tax reductions for individuals and corporations as well as a more equal distribution of the tax burden. Despite the harmony between the government and the ruling party, Diet passage of a tax reform package remains uncertain.

Although the general contents of the government Tax System Council's report were leaked April 22, the report was not formally handed to the prime minister for six days. The delay was needed to iron out some details and to

tax panel, government officials, opposition parties and businessmen began April 10 to establish the exact rate of the indirect tax. The commission hopes to have this point clarified by May 20, when it will move on to the tax's form. The government and LDP hope to conclude talks by the end of June in preparation for convening a special Diet session in July.

Prime Minister Takeshita is clearly trying to avoid the trap that caught his predecessor by working to get a national consensus on the indirect tax. The opposition remains opposed to the new levy, but the general mood of the nation is that it is inevitable. While Mr. Takeshita has had his way on nearly every tax proposal so far, many obstacles lie in the path to tax reform.

Jon Choy

Japan's Payments Surplus Inches Down

The process may seem painfully slow, but Japan continues to make progress in whittling down its huge balance of payments surplus. In the January-March 1988 quarter the trade imbalance was down 9 percent in dollar terms and the current account surplus dropped 11.8 percent, the fourth straight quarter of year-to-year declines (see Table 1). Both figures, however, are still substantially above the levels recorded two years ago.

Table 1: Japan's Balance of Payments

(in millions of dollars)

	Trade Balance	Exports (f.o.b.)	Imports (f.o.b.)	Services (net)	Current Account Balance	Long-Term Capital (net)
1983	$31,454	$145,468	$114,014	$-9,106	$20,799	$-17,700
1984	44,257	168,290	124,033	-7,747	35,003	-49,651
1985	55,986	174,015	118,029	-5,165	49,169	-64,542
1986	92,827	205,591	112,764	-4,932	85,845	-131,461
1987 (p)	96,464	224,432	127,968	-6,099	86,688	-137,127
1986:I	14,552	44,813	30,261	-1,145	12,668	-18,990
1986:II	23,922	52,270	28,348	-374	23,099	-28,882
1986:III	26,793	53,859	27,066	-1,922	24,413	-38,410
1986:IV	27,560	54,649	27,089	-1,491	25,665	-45,179
1987:I	23,373	50,515	27,142	-1,348	20,962	-32,209
1987:II	25,038	55,823	30,785	-1,601	22,762	-44,365
1987:III	23,585	56,600	32,015	-1,757	21,189	-22,023
1987:IV (p)	24,468	61,494	37,026	-1,393	21,775	-38,530
1988:I (p)	21,268	59,299	38,031	-1,500	18,487	-15,305

Source: Bank of Japan

For fiscal 1987 (ended March 31), Japan registered a current account surplus of $84.5 billion, the first decline -- albeit a modest one -- in six years. The fiscal 1986 figure was $94.1 billion. The trade surplus came in at $94.3 billion in FY 1987, down from $101.6 billion.

In the latest quarter imports continued to lead the way, rising a whopping 40.1 percent from a year earlier in dollar terms. Even yen-denominated purchases rose 17.1 percent. Exports were up in terms of dollars but almost flat in yen, a pattern also evident in the customs-clearance trade data released earlier (see JEI Report No. 16B, April 22, 1988).

The most dramatic year-to-year change was in the long-term capital account. The figures for the first quarter suggest that investor sentiment is changing: the net outflow for the quarter was the smallest since the first quarter of 1985, more than compensating for the somewhat lower current account surplus. (The figures in Table 1 refer to net long-term capital inflows to Japan by foreigners minus net long-term outflows of Japanese capital to the rest of the world, not just to the United States, although this country accounts for a sizable chunk. Japanese investment overseas substantially exceeds foreign investment in Japan.)

Wall Street has kept a wary eye on Japanese investors, worried that life insurance companies and others will cut their losses from the dollar's drop against the yen and withdraw or at least stop adding to their holdings of American securities. Japanese participation in overseas bond and stock markets is shown in Table 2. Bond holdings grew slowly in the first quarter, with net purchases in all foreign markets down 43 percent from a year earlier while Japanese investors were actually net sellers of stock on overseas markets.

Table 2: Japan's Net Purchases of Foreign Securities

(in millions of dollars)

	Bonds			Stocks		
	Purchases	Sales	Net	Purchases	Sales	Net
1983	$22,905	$10,400	$12,505	$2,106	$1,445	$661
1984	56,348	29,575	26,773	1,570	1,519	51
1985	291,338	237,859	53,479	5,484	4,489	995
1986	1,346,989	1,253,965	93,024	20,917	13,869	7,048
1987 (p)	1,273,829	1,200,944	72,885	70,936	54,062	16,874
1986:I	251,591	234,330	17,261	2,793	1,961	832
1986:II	368,271	343,467	24,804	3,717	2,260	1,457
1986:III	357,331	330,980	26,351	6,481	4,473	2,008
1986:IV	369,796	345,188	24,608	7,926	5,175	2,751
1987:I	377,850	354,648	23,202	13,925	9,386	4,539
1987:II	341,880	316,585	25,295	15,277	9,797	5,480
1987:III	325,517	308,421	17,096	21,882	18,370	3,512
1988:IV (p)	228,582	221,290	16,509	19,852	16,509	3,343
1988:I (p)	332,047	318,877	13,170	18,901	19,466	-566

Source: Ministry of Finance

However, gauging the intentions of Japanese investors from changes in net capital flows may yield an exaggerated picture. The largest quarter-to-quarter swing factor in international equity and bond investment was not Japanese. Foreigners had been selling their stock holdings in Japan for seven straight quarters, a movement that peaked in the last quarter of 1987 when they unloaded a net $21.5 billion in Japanese equities. Apparently attracted by the strength of the Tokyo stock market after Black Monday, American and other investors rushed back in earlier this year, purchasing a net $5.9 billion worth of stock in the first quarter, an all-time high. Since foreign investment in Japan reduces net capital outflows, this $27.4 billion swing was in the same direction but substantially larger than the quarter-to-quarter reduction in net Japanese purchases of stocks and bonds shown in Table 2. Together they contributed to the smaller net long-term capital outflow shown in Table 1.

If the trends hold up, it could mean future pressure on the dollar, both from Japanese investors buying fewer dollars for bond and equity investments and Americans and others supplying more dollars to the market as they acquire yen to buy Japanese equities. Central banks would then either have to pick up the difference or let the dollar fall. While shrouded in secrecy and statistical imprecision, burgeoning foreign exchange reserves in the face of declining private capital outflows indicate the Bank of Japan may already be trying to offset the actions of American, Japanese and other investors.

Douglas Ostrom

Takeshita Elaborates Foreign Policy Goals

In a May 4 speech in London, Prime Minister Noboru Takeshita presented the much ballyhooed "International Cooperation Initiative," a three-part plan involving Japanese support for international peace initiatives, greater cultural exchanges between Japan and other countries and expanded official development assistance. Mr. Takeshita said the three-part initiative constituted the "main pillar" of his foreign policy and pledged to work with his European counterparts to usher in a "new era in Japanese-European relations."

For a prime minister considered less interested in international affairs than his predecessor, this address -- and in fact his entire European tour (see JEI Report No. 18B, May 6, 1988) -- appears to indicate that Mr. Takeshita wants to leave his imprint on Japan's foreign policy and act as a global leader in his own right. "I believe that it is Japan's responsibility as a major industrialized democracy to play a positive role commensurate with its increased national strength to maintain peace in the world and to secure the prosperity of the international community," he said. This conviction prompted British Prime Minister Margaret Thatcher to remark that not only was a closer Japan-Europe relationship welcome, but that Britain intended to encourage further Japanese investment based on the sound record that Japanese firms have established so far.

The main thrust of Mr. Takeshita's meetings with British, Italian and West German leaders concerned trade matters. As expected, Mrs. Thatcher pressed the prime minister to lift Tokyo's tax on imported liquor and wine. Mr. Takeshita reportedly said that Japan is planning to revise the liquor tax as part of its comprehensive tax reform effort, but Mrs. Thatcher argued for a